Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	February 22, 2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Agricultural Product Donations Credit

SUMMARY

This bill would create a credit for taxpayers that donate agricultural products to food banks.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to encourage taxpayers, including farmers, to donate agricultural products to food banks.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would apply to taxable years beginning on or after January 1, 2002, and before January 1, 2007.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author with amendments to resolve the concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Under **current federal and state laws**, generally all ordinary and necessary expenses of a trade or business are deductible. For taxpayers required to use an inventory method of accounting, certain business expenses are deducted as part of their costs of goods sold. Inventories include all goods that are held for sale in the ordinary course of business or that are to become a physical part of goods for sale to customers in the ordinary course of business.

Board Position:			Department Director	Date
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There are four methods farmers use to value inventory: 1) the cost method; 2) the lower-of-cost-or-market method; 3) the farm price method; and 4) the unit-livestock-price method. The two most commonly recognized methods of valuing inventories are cost and the lower-of-cost-or-market whichever is lower. Costs of goods on hand at the start of an accounting period are the amount at which they were valued in the closing inventory of the prior period. Costs of goods ordinarily purchased are the invoice price minus trade or other discounts. Costs of goods produced by the taxpayer include raw materials and supplies entering into or consumed in manufacturing, regular and overtime direct labor costs, and certain required indirect costs.

Under **current federal and state laws**, a taxpayer may claim a deduction for charitable contributions made to qualified organizations. A charitable contribution is a gift given to or for the use of a qualified organization. It may be in the form of money or property, or unreimbursed out-of-pocket expenses incurred by the taxpayer for services rendered to the organization.

For a charitable gift of ordinary income-type property, the amount considered contributed (the property's fair market value (FMV)) must be reduced by the amount of ordinary income or short-term capital gain that would have been recognized if the property had been sold by the donor for its FMV. Ordinary income-type property is property that would have resulted in some amount of gain, other than long-term capital gain, if sold at its FMV on the date it was contributed.

Under **current federal law**, if a C corporation contributes inventory to a qualified organization, the C corporation would make only half the reduction discussed above. However, the resulting charitable contribution deduction could not exceed twice the basis of the contributed property.

Current state law also provides a credit equal to 50% of the transportation costs paid or incurred for transporting any donated agricultural product to a nonprofit charitable organization.

Under the **Food and Agriculture Code**, a person engaged in the business of processing, distributing, or selling agricultural products may donate food to a nonprofit charitable organization. Agricultural products include fowl, animal, vegetable, or other stuff, product, or article that is customary or proper food for human beings. (The Food and Agriculture Code does not specify a benefit for the donation. However, if the donee was a qualified organization for federal and state tax purposes, the donor could take an itemized deduction for the contribution under federal and state tax laws.)

<u>THIS BILL</u>

This bill would:

- Allow a credit equal to 10% of the costs included or that would normally be required to be included in inventory costs.

- Specify that a husband and wife be entitled to only one credit. If filing separately, the credit may be taken by either spouse or equally divided between them. Except for a husband and wife, if two or more taxpayers share in expenses eligible for this credit, each taxpayer would receive the tax credit in proportion to his or her respective share of the expense paid or incurred. In the case of a partnership, the tax credit may be divided pursuant to a written partnership agreement relating to the partner's distributive share. A partner’s distributive share of the credit must have substantial economic effect.

- Specify that any deduction taken for any expenses claimed for this credit must be reduced by the amount of the credit.

- Specify that the nonprofit organization would provide the donor with certification of the donation. The certificate would contain: 1) a statement signed and dated by an authorized organization representative that the donation is made under the Food and Agriculture Code; 2) the type and quantity of product donated; 3) the name of the donor(s); and 4) the name and address of the donee.

- Specify that the credit may be carried over until exhausted.

IMPLEMENTATION CONSIDERATION

The department has identified the following implementation concern. Department staff is available to work with the author's staff to resolve these and other concerns that may be identified.

This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows that credits typically are exhausted within eight years of being earned.

TECHNICAL CONSIDERATION

The language in subdivision (b) discussing the treatment of the credit by husbands and wives, persons that share expenses, and partners is declarative of existing law and should be deleted. Amendments 1 and 2 are provided.

LEGISLATIVE HISTORY

AB 287 (Strickland, 1999/2000) would have created a tax credit equal to 10% of the wholesale value of agricultural products donated by a taxpayer to a nonprofit charitable organization or food bank. This bill failed to pass out of its house of origin by January 31st of the second year of the legislative session.

AB 196 (Thomson, 1997/1998) would have created a tax credit equal to 20% of the cost of agricultural products donated to a nonprofit charitable organization. This bill failed passage out of the Senate Appropriations Committee.

SB 38 (Lockyer, Stats. 1996, Ch. 954) created a tax credit for the transportation of agricultural products donated to a nonprofit charitable organization or food bank.

AB 364 (Cannella, 1995/1996) would have created a tax credit equal to 10% of the cost of food donated to nonprofit charitable organizations and a tax credit equal to 50% of the cost of transporting the donated food. This bill failed passage out of the Senate Appropriations Committee.

AB 2346 (Kelley, Stats. 1989, Ch. 1248) created a tax credit identical to this bill for the donation of agricultural products to certain nonprofit charitable organizations. That credit expired December 1, 1992.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota*, and *New York* tax laws did not reveal that these states offer similar tax credits. These states were chosen for their similarities to California state law or state population or both.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

This proposal is estimated to impact PIT and B&CT revenue as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2001 Enactment Assumed After June 30, 2001 $ Millions		
2002/2003	2003/2004	2004/2005
-$2	-$2	-$2

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Tax Revenue Discussion

The revenue impact for this bill will be determined by the inventory costs of donated agricultural products and the amount of credits that can be applied against available tax liabilities.

The above estimates are based on historical state data from 1989 through 1991 for the prior state credit of 10% (based on inventory cost). The credit amount was grown 5% per year to reflect increases in inventory costs.

POLICY CONCERN

Farmers generally would not be required to use the inventory cost method. Costing inventory is a complex procedure. Four separate costing methods exist, each with its own intricate set of rules. As a result, some targeted taxpayers may choose not to claim this credit.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 727
As Introduced February 22, 2001

AMENDMENT 1

On page 2, delete lines 11 through 23 and redesignate remaining subdivisions accordingly.

AMENDMENT 2

On page 3, delete lines 19 through 27 and redesignate remaining subdivisions accordingly.